



CITY OF LODI

COUNCIL COMMUNICATION

AGENDA TITLE: Discussion Regarding Proposed Audit (Agreed-Upon Procedures) of Envision Law Group

MEETING DATE: November 19, 2003

SUBMITTED BY: Janet S. Keeter, Deputy City Manager

RECOMMENDATION: That Council Member Hansen lead the Council in a discussion regarding a proposed "audit" of the Envision Law Group's billings and take appropriate action.

BACKGROUND INFORMATION: During the October 15, 2003 City Council meeting, Council Member Larry Hansen requested that Council consider conducting an "audit" of the Envision Law Group's billings for the PCE/TCE litigation matter. His request was made during Council Comments and is now coming before Council for discussion as an agenda item.

Council Member Hansen will lead the discussion regarding his request and has prepared background information (Exhibit A) and a copy of e-mail correspondence between Finance Director Vicky McAthie and Scott Brunner, Director of the City's auditing firm Macias, Gini & Company (Exhibit B) for Council's information.

Funding: Not applicable

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Janet S. Keeter", with a long horizontal flourish extending to the right.

Janet S. Keeter
Deputy City Manager

Attachments

APPROVED: _____

A handwritten signature in black ink, appearing to read "H. Dixon Flynn", with a long horizontal flourish extending to the right.
H. Dixon Flynn -- City Manager

BACKGROUND INFORMATION: One of the issues raised by the media and many concerned citizens is the approved expenditures of the Envision Law Firm and the many questions about how the City's money is being spent. At the October 15th Council meeting, Council Member Larry Hansen requested that the City find a means to have the City financial records audited. It was discussed whether to use an attorney or to use the City auditors to conduct the audit.

On October 16th, our Finance Director, Vicky McAthie sent an e-mail to Scott Brunner, a CPA and Director of our current auditing firm. The original e-mail from Ms. McAthie and Mr. Brunner's response are attached to this communication. Mr. Brunner suggested that rather than an audit per se, we might want to consider an "Agreed Upon Procedures Engagement". This type of procedure is one in which the auditor is engaged to perform specific procedures and report the findings. The auditor does not perform an examination or provide an opinion. Rather the auditor reports only procedures and findings which are very specific and concise. The procedure should generally meet the following two tests:

- They should address the nature, timing and extent.
- They should result in findings that are capable of reasonably consistent estimation or measurement.

An agreed upon procedure might focus on the following three specific areas of concern: related documents, expenditures and receipts.

Related documents:

- Review agreement signed with Envision Law and USF&G re: reimbursement for expenditures, agreed upon rates and agreed upon deductions.
- Review agreement with Lehman financing and quarterly caps set forth in the Program Receipts Sale and Repurchase Agreement.
- Review Court's February 28, 2003 agreed order re: USF&G's duty to defend and to whom payments should be made.
- Review where Wells Fargo Bank statements are going.

Expenditures:

- Review expenditures vs. industry standard.
- Review expenditures and invoices sent to USF&G.

Receipts:

- Review receipts received from USF&G focusing on:
 - Ongoing defense costs or recoveries subject to Lehman Financing Agreement.
 - What parsing out is done to make sure the City of Lodi meets its obligations to the holders of the COP under the Lehman financing and Envision Law Group, LLP.
- Review payments received by Envision Law: when received and when released to the City, and determine any interest due to the City.
- Review advance from USF&G for the Environmental Site Investigation and how that is associated with Lehman financing receipts applied to DTSC reserve.
- Review any non-cash payments received and the impact that they would have on the Lehman financing.

Susan Lake

From: Janet Keeter
Sent: Tuesday, November 11, 2003 4:44 PM
To: Susan Lake
Subject: Envision

Janet S. Keeter

-----Original Message-----

From: Scott Brunner [mailto:sbrunner@maciasgini.com]
Sent: Thursday, October 16, 2003 4:41 PM
To: Vicky McAthie
Cc: City Council; Susan Blackston; Janet Keeter; Randy Hays
Subject: RE:

Hi Vicky,

In know this is long, but the more information you have the greater the likelihood that we get this process off on the right foot.

This type of engagement isn't really an audit, per se. It sounds as though what you're looking for is what's called an agreed-upon procedures engagement. I know it's only a technicality as non-auditors generally call an agreed-upon procedures engagement an audit as it's conducted by auditors, but I want to make the distinction clear. As an audit report states, "an audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation." An agreed-upon procedures engagement is one in which the auditor is engaged to perform specific procedures and report findings. The auditor does not perform an examination or provide an opinion. Rather, the auditor reports only procedures and findings.

In other words, an audit is very broad and not absolute or exact, hence an opinion is given. In an audit, it is up to the auditor's discretion of what procedures to perform in order to provide the opinion. An agreed-upon procedures engagement is very specific and concise. The client provides the auditor with the very specific procedures they'd like performed, and the auditor reports what exactly they did or did not find. Nothing's left up to the auditor for interpretation, not even materiality.

However, before we can quote you a fee, we need to know how long the engagement will take. And before we can determine how long the engagement will take, we need to know very specifically the procedures you'd like performed. The following are some guidelines you should follow in developing the procedures you'd like performed:

Examples of procedures that would generally be considered appropriate for an agreed-upon procedures engagement include the following:

- Inspecting specific documents for evidence of certain types of transactions or characteristics.
- Comparing certain documents, schedules, or analyses with specific attributes.
- Performing agreed-upon mathematical computations.
- Executing a sample application after agreeing on relevant parameters.
- Confirming specific information with third parties.

To be appropriate, procedures should generally meet the following two tests:

- They should address nature, timing, and extent.

- They should result in findings that are capable of reasonably consistent estimation or measurement. In other words, for a procedure to be appropriate, the auditor should be able to demonstrate that they accomplished it.

In an agreed-upon procedures engagement, the auditor may generally perform any procedures requested provided the procedures are not overly subjective, described in an unclear manner, or open to varying interpretation. This is because the auditor's report should clearly list and describe the procedures performed. Examples of procedures that are not sufficiently clear include:

- Performing a "general review" of the company's accounts receivable.
- "Checking" the company's inventory balances.
- "Reconciling" the company's cash accounts.
- "Testing" the company's accounts payable balances.
- Performing a "limited review" of the company's cash accounts.

Use of vague terms such as these should generally be avoided. If they must be used, they should be accompanied by an explanation of what procedures are meant by the terms. In addition to procedures that are described in a vague or unclear manner, the following procedures would normally also be considered inappropriate because they do not result in findings that are meaningful:

- Mere reading of the subject matter. (However, reading the subject matter is appropriate if it is performed in addition to other procedures.)
- Mere reading of the work performed by others solely to describe their findings.
- Evaluating the competency or objectivity of another party.
- Obtaining an understanding about a particular subject.
- Interpreting documents outside the scope of the auditor's professional expertise.

This should give you some good information to take back to the City Council to determine what exactly you'd like us to do. Once that's determined, we can determine what it will take and cost. Please let us know if we can be of any further help.

Thank you,

Scott A. Brunner, CPA
Director
Macias, Gini & Company LLP

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fax - (916) 928-2755
sbrunner@maciasgini.com

-----Original Message-----

From: Vicky McAthie [mailto:vmcathie@lodi.gov]
Sent: Thursday, October 16, 2003 11:14 AM
To: sbrunner@maciasgini.com
Cc: City Council; Susan Blackston; Janet Keeter; Randy Hays
Subject:

Scott,

As you are aware there has been a lot of discussion on the PCE/TCE legal issue. Last night at the Council meeting, one of the Council members asked about the feasibility of the city audit firm auditing the outside legal firm's books for reasonableness of the bills they submit to the City for payment. Questions have been raised about what the industry practice is for charges for items such as limo, meals etc.

This of course was not part of the scope of our annual audit so we would also like to get an estimate of charges for this type of audit. The scope of the audit may also include auditing of payments received by Envision Law for the City of Lodi, the audit of any reduction of those payments for Envision Law invoices that are above the cap allowable by the formula used for the request for funds from the financing, the timing of those payments to the City, and any interest accrued/due the City. I have a copy of questions of this nature that I have asked Envision Law and the responses they have sent me. I can make this available to you for your audit work papers.

Please let me know if this is something your audit firm would be able to take on, and if so what an estimate of the charges for this type of audit would be. If your firm is not able to take this on currently, please let me know if you can recommend another audit firm with expertise in this area.

I look forward to hearing from you Scott.

Vicky

Vicky McAthie
Finance Director





CITY OF LODI COUNCIL COMMUNICATION

AGENDA TITLE: Discussion Regarding Proposed Audit (agreed-upon procedures) of Envision Law Group's Billings

MEETING DATE: November 19, 2003

PREPARED BY: Council Member Larry Hansen

RECOMMENDED ACTION: That Council discuss the proposed audit (agreed-upon procedures) of Envision Law Group's billings and 1) authorize that the law offices of Barger & Wolen LLP be retained, 2) appropriate an initial retainer of \$50,000, and 3) authorize Council Member Hansen and Mayor Hitchcock to negotiate a contract.

BACKGROUND INFORMATION: As the City's lengthy and complicated environmental abatement program litigation moves forward, there are many issues to be resolved. Some of the issues raised by Council Members, the media, and/or citizens focus on the financing of the litigation, the cost of the litigation, and the length of the litigation. Because of these concerns, the City Council voted to seek a second opinion (refer to Council Communication and minutes from September 17, 2003). Council Member Beckman made a motion, Hitchcock second, to direct the City to officially seek a professional evaluation/additional opinion on the following matters related to the environmental abatement program:

1. Financial agreement (with Lehman Bros., Inc.), evaluation to include possible ramifications to the City of various scenarios that could occur;
2. Determine other potential options and strategies that the City could pursue in regard to the PCE/TCE litigation; and
3. Valuation of the City's current strategy.

The above motion carried by the following vote:

Ayes – Council Members: Beckman, Hansen, and Mayor Hitchcock

Noes – Council Members: Howard and Land

Council Member Hansen and Mayor Hitchcock were charged with the responsibility of finding attorneys to offer the second opinion. Approximately 15 attorneys/law firms have been interviewed by either Council Member Hansen or Mayor Hitchcock. During this process, two attorneys were found with experience in auditing lengthy and costly litigation cases. Mayor Hitchcock and Council Member Hansen interviewed the attorneys, Robert G. Levy and David J. McMahon of the law firm Barger & Wolen LLP. Mr. Levy has concentration in insurance coverage, professional liability litigation, and attorneys' fee dispute issues for

APPROVED: _____
H. Dixon Flynn, City Manager

the past 22 years. He was formerly the coverage counsel, statewide, for a major California legal malpractice insurer. He is qualified as a trial expert witness on the duties of insurance coverage counsel, and he has served as an expert witness on allocation between covered and non-covered claims in patent infringement litigation. Mr. McMahon has worked for Barger & Wolen LLP since January 1995, and his practice areas are complex business, financial and regulatory litigation, environmental cost containment practice, and appellate work.

Barger & Wolen LLP was retained as Associate Remedial Liaison Counsel in the Lincoln Properties case. In this role, they were hired by the Settling Dry Cleaning Defendants to review and analyze the bills submitted for payment by the law firm of Zevnik, Horton, Guibord & McGovern, et al. (the "Zevnik firm"). The Zevnik firm was performing oversight and monitoring on behalf of their client, Lincoln Properties, in an environmental cleanup taking place at a shopping center located in Stockton. At that time Mr. Michael Donovan worked for the Zevnik firm, and eventually moved to the Envision Law Group. Barger & Wolen was also asked to review and analyze the invoices submitted by a number of the consultants who worked on the case with the Zevnik firm.

During their retention, where they observed bills that did not comply with generally accepted billing practices or which were not properly documented, Barger & Wolen filed dispute petitions in court in accordance with the case management order which was applicable in that case. The petitions were heard and decided by the Honorable David H. Weinstein with Judicial Arbitration & Mediation Services (JAMS) who was serving as Special Master, appointed by the Honorable David Levi. In certain cases, the decisions of Judge Weinstein were appealed to the federal district court judge who was in charge of the case, the Honorable David Levi.

Ultimately, Barger & Wolen LLP was involved in bringing a motion to amend the consent decree, which governed the cleanup in the case. The motion resulted in a resolution of the case through settlement.

Summary of Barger & Wolen LLP Qualifications:

1. Over the years, Barger & Wolen LLP has worked on more than 60 cases dealing with issues relating to litigation management, the reasonableness of attorneys' fees and the ethics of hourly billing. In the past several years, Barger & Wolen has been involved in cases decided by the Arizona, Montana, Georgia, and Florida Supreme Courts wherein ethical issues pertaining to the use of billing guidelines, legal auditing, and related issues have been decided.
2. Since 1991 Barger & Wolen LLP has litigated dozens of cases in which ethical considerations and/or the reasonableness of attorneys' fees and costs have been the central issue. During the last ten years, they have served as a litigator and consultant in a wide range of fee dispute cases, including environmental contamination, toxic tort matters, mass tort litigation, asbestos litigation, complex commercial disputes, and insurance overage/fee disputes. These cases have often involved disputes between clients and independently retained counsel, *Cumis* fee disputes, panel counsel fee disputes and attorneys' fee arbitrations. Since 1991 they have reviewed and analyzed hundreds of millions of dollars in law firm invoices reflecting legal fees and costs generated in litigation matters.
3. As a litigator of attorneys' fee cases, Barger & Wolen LLP has been involved in appellate advocacy, litigation, arbitration, and mediation concerning law firm fees and related ethical issues in many jurisdictions throughout the United States, including California, Florida, Texas, Alaska, Arizona, Georgia, Montana, Tennessee, and Utah.

4. Barger & Wolen LLP is constrained from providing details about some of these matters because of confidentiality orders or stipulations, which prohibit us from disclosing detailed information including, in some instances, the identity of the law firms involved.
5. As a consultant to various clients and companies in attorneys' fees matters, they have assisted clients, including corporations and insurance companies in drafting attorney billing guidelines for use by attorneys defending complex litigation.
6. Barger & Wolen LLP has also worked on a number of cases in which law firms have hired their firm to assist in their analysis of the reasonableness and necessity of fees and costs in ongoing litigation.

This law firm has the expertise and experience necessary to determine if the legal fees incurred by the City have been reasonable and necessary.

FUNDING: Water Fund \$50,000

Ruby R. Gairie for
Vicky McAthie, Finance Director

Larry D. Hansen
Larry D. Hansen
Council Member